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In the Supreme Court of the United States

OCTOBER TERM, 1962

No. 275

ESTATE OF FLOYD B. FAULKERSON, DECEASED, BERNIECE E. FAULKERSON, ADMINISTRATRIX, PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

OPINIONS BELOW

The opinion of the district court (Pet. 11–16) is reported at 193 F. Supp. 410. The opinion of the court of appeals (Pet. 17–22) is reported at 301 F. 2d 231.

JURISDICTION

The judgment of the court of appeals was entered on March 28, 1962. A petition for rehearing was denied on April 26, 1962. The petition for a writ of certiorari was filed on July 25, 1962. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTION PRESENTED

A decedent's will in terms gave his widow a life estate with remainders to his two adult children. On a petition filed by the widow-administratrix and unopposed by the children, however, the county probate court entered an order directing distribution of the property in fee to the widow "as the sole beneficiary". The question is whether the probate court's "construction" of the will as giving the widow a fee interest rather than a life estate is binding upon the United States to establish the right of the estate to a marital deduction under § 2056 of the Internal Revenue Code of 1954.

STATEMENT

1. Floyd Faulkerson died on December 27, 1954, being survived by his wife and two children, each aged 39. His will, after providing for the payment of debts and expenses, provided in part:

> Item II. Subject to Item I, I hereby give, devise and bequeath to my wife, Berniece E. Faulkerson, if she survives me, the use, income, rents and profits of my entire estate for and during her life, together with the power to sell any of the assets comprising my estate, consisting principally of Trust Shares, First Mortgage Bonds, Stocks and Real Estate, for the purpose only of preventing loss and depreciation therein and for reinvestment.
>
> Item III. Subject to the preceding items, I hereby give, devise and bequeath all the rest, residue and remainder of my estate of whatsoever kind or character from and after the death of my wife, Berniece E. Faulkerson, to

> the Lincoln National Bank and Trust Company of Fort Wayne, Indiana, to be held in trust by it for the use and benefit of my children, Robert Faulkerson and Elizabeth Faulkerson, equally, until they shall attain the age of thirty-five years. The said Lincoln National Bank and Trust Company, as trustee, shall collect and receive all rents, profits, and income from said estate and shall pay the same to the said beneficiaries hereunder equally, for and during the terms of years above set forth. And at the time that said children respectively reach the age of thirty-five years, the said trustee shall turn over, assign and transfer to said child so reaching said age, his or her one-half interest in the principal of said trust fund, the balance to be held in trust until said other child shall be entitled thereto under the terms of this will. * * *

The decedent's widow, the petitioner here, offered the will for probate in the Steuben Circuit Court, Steuben County, Indiana, and duly qualified as administratrix of the estate.

On August 19, 1955, the petitioner filed a petition with the Steuben Circuit Court praying, without explanation or reference to the terms of the will, that the securities belonging to the estate "be transferred to her as the sole beneficiary under the will" (G.R.[1] 9). On the same day, the court entered an order reading in part as follows (G.R. 10–11):

> * * * the court having seen and inspected said petition finds that Berniece E. Faulkerson is

[1] "G.R." refers to the appendix to the government's (appellee's) brief in the court of appeals.

> the sole beneficiary under the Will of Floyd B. Faulkerson * * *.
>
> It is, therefore, ordered, adjudged and decreed by the court that the following stocks should be transferred into the name of Berniece E. Faulkerson as the sole beneficiary under the Will of Floyd B. Faulkerson * * *.

After further intervening proceedings (relating to payment of taxes, *etc.*), the petitioner filed a final account reciting that the "Entire residue of Estate goes to [the petitioner] * * * under the Last Will and Testament" and requesting authority to make such distribution (G.R. 18). On January 13, 1956, an order was entered approving the final account and authorizing distribution pursuant to it; the petitioner filed a supplemental report reciting that the entire residuary estate had been distributed to herself "as sole beneficiary under said Will"; and the court entered an order approving the supplemental report and discharging the petitioner of any further duties as administratrix (G.R. 19–22).

The two children of the decedent had notice of the proceedings in the Steuben Circuit Court but entered no appearance and did not contest the distributions proposed by the petitioner and approved by the court (Pet. 3).

2. In filing the federal estate tax return, the petitioner deducted one-half of the adjusted gross estate as a marital deduction under § 2056 of the Internal Revenue Code of 1954. The Commissioner disallowed the deduction and petitioner, after paying the resulting deficiency, brought this suit for refund. The Court of Appeals for the Seventh Circuit, affirming

the district court, held that there passed to the petitioner under the decedent's will only a life estate which, being a terminable interest, did not qualify for the marital deduction. In rejecting the petitioner's contention that the probate court's orders constituted a binding determination that the will gave her a fee interest rather than a life estate, the court said (Pet. 19–20):

> The decree of the Steuben Circuit Court was rendered in an *ex parte*, nonadversary proceeding, without a hearing on the merits. It reached a result contrary to Indiana law and Treasury Regulations. The decree was obtained in a proceeding that was collusive in the sense that a decision was sought which would adversely affect the Government's right to additional estate tax. The Steuben Circuit Court is one of approximately 84 such courts of equal jurisdiction in Indiana whose decisions are not binding on each other. Under all these circumstances, we hold that the district court was not bound by such decree. * * *

ARGUMENT

A close examination of the facts of *Gallagher* v. *Smith*, 223 F. 2d 218 (C.A. 3), lends support to petitioner's claim that the result reached on one aspect of that case is in conflict with the result reached below. The principles stated by the Third Circuit in its opinion, however, seem on their face to be fully consistent with those applied in this case, and whether the difference in result is attributable merely to a mistaken application of those principles to the particular facts or to a basic difference of approach remains uncer-

tain. Accordingly, while there are indications that there is a developing conflict between the circuits, it has not in our view matured to a point requiring review by this Court. And while the issue is of substantial importance even apart from the existence of a conflict, its resolution by this Court can profitably await further clarifying developments in the lower courts.

1. If the necessary distinction be made between a court's "decree" (its exertion of judicial power to prescribe or command what the rights of the parties shall be) and its "decision" of issues of fact or law upon which the issuance of the decree is based, we have no disagreement with petitioner over the effect to be given to State court *decrees* for tax purposes. Assuming the decree is final and binding as a matter of State law (*i.e.*, is not subject to being set aside or modified on collateral attack) it is itself an operative event creating and fixing the rights of the parties from and after its entry. It equally has that effect, moreover, whether its entry be based upon a resolution of contested issues of law or fact or merely upon the unanimous consent of all interested parties, or whether, if the former, the decision be "right" or "wrong" as a matter of principle. If, then, the Internal Revenue Code makes a tax consequence turn solely upon the property rights existent after the entry of a decree, the decree fixing those rights, being entitled to full faith and credit, is necessarily controlling without regard to whether it was entered with

the consent of the parties or as a result of an adversary proceeding.[2]

While the petitioner fails to make the distinction, her contention depends, not upon giving binding effect merely to the State court's *decree,* but upon the federal government's being bound also by the State court's *reasoning upon a question of law* as the purported basis for entering the decree. The decree or "command" of the State court here was that the widow have henceforth absolute ownership of all the property of the estate, and we acknowledge that, from and after the entry of the decree, the widow must be treated as the full and absolute owner of the property for federal tax purposes as well as for all other purposes.[3] That, however, does not answer the question upon which the tax consequences in this case turn, which is, not whether the widow now owns the property, but whether she acquired it by virtue of rights of descent from the decedent (here, under the will).

Section 2056 allows a marital deduction only for a nonterminable "interest in property which passes * * * from the decedent to his surviving spouse."

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[2] For example, the taxability of income from property normally depends solely upon who owns the property at the time the income is produced, regardless of how he came to own it. Thus a decree awarding property to a person will automatically determine the taxability of the income thereafter produced by the property regardless of how "wrong" the decree may have been as a matter of principle or whether it was based on the consent of the parties.

[3] As a result of the binding effect of the decree, for example, the property will be includible in her estate for estate tax purposes.

If the widow had clearly been given under the terms of the will only a life estate; if the remaindermen had nevertheless expressly consented to, and urged the State court to enter, a decree foreclosing their rights and giving the widow instead a fee simple estate; and if the State court had entered such a decree expressly on the basis of the parties' consent, the decree would have had the same effect but the estate, equally plainly, would not have been entitled to a marital deduction. The widow would have received a fee interest but she would have received it, not because the will gave it to her, but by virtue of what amounts to a "gift" from the remaindermen; the fee interest would not have "passed" to her "from the decedent" and would thus not have qualified for the marital deduction.

The part of the State court's action upon which the petitioner must rely, accordingly, is not the *decree* as such but the underlying *reasoning*, upon which the decree was purportedly based, construing the will as devising to the widow a fee interest rather than merely a life estate. The question, in short, is not one of the effect to be given to a State court's decree but of the effect to be given to its resolution of the underlying issues of law or fact upon which the decree purports to be grounded.

2. On that issue, the petitioner asserts a conflict with the decision of the Third Circuit in *Gallagher* v. *Smith*, 223 F. 2d 218. The recent decisions of the Third Circuit do reveal, we think, an underlying difference in principle between that court and other courts of appeals—including the Seventh Circuit's

decision in this case—in the effect given to decisions of State courts in uncontested proceedings, and we would welcome clarification of the question by this Court. As yet, however, we do not believe that there is such a square conflict of actual holdings as to require review by this Court.

In the *Gallagher* case, a decedent dying in 1942 devised property in trust to pay the income to his widow for life and then to distribute the property to his twelve children. A spendthrift provision directed that the corpus and income were to be free of "all debts, contracts, transfers, hypothecations and anticipations of my wife or children." The widow purported to renounce and disclaim any interest given her by the will except for a one-thirteenth interest in the income,[4] with the consequence that, in 1943 and subsequent years, twelve-thirteenths of the income was distributed to and reported as income by the twelve children who, as remaindermen, would succeed to that interest if it had been effectively renounced. In June 1948, the probate court, reviewing the trustee's account, approved the past disbursement of income to the children and awarded the remaining undistributed income in equal shares to the widow and the children, noting that the widow had a right to disclaim or renounce her interest (as distinguished from assigning or pledging it) notwithstanding the spendthrift provision.

In a suit involving the taxable years 1943 through 1948, the Commissioner contended that the purported

[4] A written "Confirmation of Release and Disclaimer" was not executed until 1947, but it apparently purported to confirm an oral renunciation made in 1943.

disclaimer was ineffective under the spendthrift provision; that it operated only as a revocable direction to the trustee to distribute the income to the children; and that all of the income accordingly remained taxable to the widow. In considering the effect to be given to the State court proceedings, the Third Circuit's opinion on its face seems to make the very distinction we have suggested between (1) a State court's "determination of some * * * question of law or fact asserted to be involved in the federal tax case"—which "it is perfectly clear * * * cannot be res judicata against the United States" since it was not a party (p. 222)—and (2) an "adjudication of * * * a question of title" which "is conclusive of the parties' property rights" (p. 223)—which necessarily controls any tax question which depends solely upon "the person entitled to the income or other property under the state law" (p. 222). Applying that distinction to the facts of *Gallagher*, the result logically should have been that the State decree was conclusive of the taxability of the trust income accruing during the last half of 1948 (*i.e.*, following the decree) but not of that for the period from 1943 through the first half of 1948. In terms of the operative effect of the probate court's *decree* upon the property rights of the parties, the most it could have done was (1) to fix the children's rights thereafter to receive the income and (2) to release the trustee from liability for any prior disbursements and to preclude the widow from recovering any of the moneys that had been paid to the children. The first, we agree, would control the taxability of the future income of the trust, since the

Internal Revenue Code makes ownership of the income interest, however acquired, the determinant of taxability. The second consequence, however, does not determine the taxability of the prior income of the trust, since those consequences would follow even if the purported renunciation had remained revocable until the decree was entered (see p. 227, n. 2), and the Internal Revenue Code makes taxability turn upon whether a purported transfer of an income interest is revocable or irrevocable prior to the actual payment, quite apart from the ability to recover the payment once made. The part of the State court's action relevant to the taxability of the pre-1948 income, therefore, was not the judgment or decree itself, but the court's "determination" of a "question of fact or law" preliminary to the entry of the decree—namely, whether in fact the widow had attempted to renounce her interest and whether in law she had had the capacity to do so. Under the Third Circuit's own rationale, therefore, it should have held the State court's action conclusive only as to the last six months of the six-year period involved. Had it done so, there would, in turn, have been no basis for a claim of conflict in this case.

The difficulty is that the Third Circuit, despite what seems to us the clear meaning of its articulated rationale, in fact treated the State court proceedings as conclusive of the tax question for the entire six-year period. It thus actually gave conclusive effect, not only to the *decree* creating and fixing property rights prospectively, but also to the *decision* of the questions of law or fact governing the effect under

State law of the purported disclaimer in 1943. Looking only at what the court *did*, therefore, there does seem to be a conflict of decisions.[5] If, however, the discrepancy between what the court said and what it did was attributable only to a failure of proper analysis of the facts before it and an inadvertent misapplication of principles themselves unexceptionable, there is not, we submit, the kind of conflict that requires immediate resolution by this Court.

We acknowledge that subsequent decisions of the Third Circuit would suggest that the principles actually being followed by that court are closer to what it did in *Gallagher* than to what it said, but those decisions are not themselves in any more direct conflict with this case than is *Gallagher*[6] and the principles of law adhered to by that court remain ambiguous. Under the circumstances, the appropriate course, we suggest, is to await clarification of the Third Circuit's

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[5] Unless of course a further distinction can be found in the "quality" of the State courts' consideration of the issues in the two cases. Compare 223 F. 2d at 224 (discussion of the *Childs' Estate* case) and 226 with the nature of the State proceedings in this case, and see note 7, *infra*.

[6] *Estate of Darlington* v. *Commissioner*, 302 F. 2d 693, and *Estate of Babcock* v. *Commissioner*, 234 F. 2d 837, can be read as being based upon a construction of the relevant provision of the Internal Revenue Code as making the operative effect of the State *decree* determinative regardless of the grounds upon which it was based. In *Beecher* v. *United States*, 280 F. 2d 202, the court based its decision alternatively upon its own reading of State law.

position in further litigation before review is undertaken by this Court.[1]

[1] The *Gallagher* case held the State court action conclusively binding as a matter of full faith and credit, and the claim of conflict in this case goes to the failure of the court below to afford similarly conclusive "credit" to the State court's decision here. The discussion in this brief has, accordingly, been limited to the extent to which State court action commands full faith and credit, and it is for that purpose that we have emphasized the dichotomy between a court's *decree* and its *decision* of the underlying issues of fact or law. In dealing with the claim of conflict in its own terms, however, we do not mean to imply that full faith and credit is the only basis upon which respect might be given to a State court's action. A State court's resolution of issues of fact or law, even though not having the imperative force of its resulting decree, might nevertheless be entitled to be accepted by federal tax tribunals simply as a matter of comity or sound principles of federalism. See *Blair v. Commissioner*, 300 U.S. 5. The extent to which the United States should be required to abide the resolution of issues in proceedings to which it is not a party as a matter of comity would depend, however, not upon the absolutes of the *Gallagher* case or of full faith or credit, but upon a pragmatic judgment taking into account such factors as the adversary or nonadversary character of the proceedings; the decision's consistency with other authoritative declarations of State law; the extent to which the court actually considered the issues on the merits; the rank of the court in the State's judicial hierarchy; and the extent to which the decision had significant non-tax consequences. However the line is ultimately to be drawn—an admittedly difficult question—under no principle of comity could the United States be bound by a mere formal recital, as in this case, contained in a probate court's order of distribution entered upon the administratrix' unopposed petition without hearing, briefs, or even acknowledgment of the issue. It is for that reason that the petitioner here must rely, not upon the more fluid principles of comity, but upon the absolutes of the *Gallagher* case and its apparent misapplication of full faith and credit principles.

CONCLUSION

For the reasons stated, the petition for a writ of certiorari should be denied.

Respectfully submitted.

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